



# CITY OF SUNNYVALE

## DEPARTMENT OF FINANCE

July 13, 2006

**TO:** Honorable Mayor and Members of the City Council

**FROM:** Mary J. Bradley, Director of Finance

**SUBJECT:** **July 18, 2006 Study Session on Update of the Fiscal Sub-Element of the General Plan**

In advance of the July 18 Study Session, attached for your review and consideration are the draft policies which have been prepared as part of our Update of the Fiscal Sub-Element of the General Plan. These financial policies form the cornerstone of the Fiscal Sub-Element and guide the City in all its fiscal decisions.

As you may know, staff has been developing the updated policies for a number of months in accordance with the Work Plan adopted by Council in November 2005 (RTC 05-322). The Work Plan has identified Council as a primary stakeholder of the City's fiscal policies, and the Study Session is being conducted to receive your input and direction on this first draft. The Study Session also provides the opportunity for public input.

Given the limited timeframe, staff concluded that it was preferable to review just the fiscal policies with Council at this initial Study Session. Subsequent to this Session, and incorporating any direction from Council, the draft policies will be reviewed by the Planning Commission and any other interested Boards and Commissions.

Over the next several weeks, we will be finalizing the additional components to the Sub-Element and will assign the appropriate numbering system. The final draft document with all of these components will be brought back to you in an additional Study Session before being considered at public hearing.

The draft policies have been expanded from the current Sub-Element to incorporate financial practices that have been adopted by Council since the document was created in 1988. Many policies from the original Sub-Element have been carried forward, as they are just as relevant today as they were in 1988. Other original policies have been reworded to reflect current terminology and usage. Finally, staff has reviewed best practices from organizations such as the Government Finance Officers Association and incorporated them as appropriate.

We look forward to discussing these policies and receiving your input on any desired changes or additions.

## **SUNNYVALE CITY COUNCIL STUDY SESSION AGENDA**

**July 18, 2006, 5:30 PM  
West Conference Room  
456 West Olive Avenue  
Sunnyvale, CA**

**Topic: Update of the Fiscal Sub-Element of the General Plan**  
(Open to the Public)

1. Call to Order
2. Roll Call
3. Study Session Purpose
4. Background of Fiscal Sub-Element
5. Development of Draft Policies
6. Review of Draft Policies
7. Council Discussion
8. Public Comments
9. Adjourn

**Fiscal Sub-Element**  
**FINANCIAL POLICIES**

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## **BUDGET POLICIES**

The City Charter requires the City Manager to prepare an annual budget and submit it to the City Council at least thirty-five days prior to the beginning of the fiscal year. The Council must adopt the budget on or before June 30th of each year.

In addition, the City prepares a Twenty-Year Resource Allocation Plan to ensure that finances are managed to maintain service delivery levels set by Council over the long term. This Plan also establishes reserves necessary to meet known and unknown future obligations. The City projects revenues, operating requirements and capital spending over the twenty-year period to provide the City Council with a tool for addressing fiscal challenges in a measured and thoughtful way.

The City uses a Performance-Based Budget system which integrates long-term planning with resource allocation by budgeting for activities to meet intended service levels which accomplish General Plan goals. Work hours, products and performance measures are recorded to determine and evaluate the efficiency and effectiveness in accomplishing budgeted activities.

### **Development of the Budget and Resource Allocation Plan**

1. The public will be encouraged to participate fully in the budget process.
2. A Fiscal Issues Workshop will be held each year prior to preparation of the City Manager's Recommended Budget to consider budget issues for the upcoming Resource Allocation Plan.
3. A balanced Twenty-Year Resource Allocation Plan shall be presented to the City Council annually.
4. The Twenty-Year Resource Allocation Plan shall be prepared on a two-year Operating Budget cycle.
5. The Operating Budget shall be approved annually with the second year approved in concept.
6. A proposed budget shall be recommended to the City Council by the City Manager no less than thirty-five days before the beginning of the fiscal year, in accordance with the City Charter.
7. At least one public hearing shall be held after the City Manager's Recommended Budget is presented to the Council in order to solicit public input before adoption.
8. The City Council shall adopt the City Manager's Recommended Budget, with any changes desired, by resolution before June 30<sup>th</sup> of each year.
9. Resources will be allocated in direct relation to General Plan goals.
10. The Resource Allocation Plan shall be prepared by General Plan element to link city resources with the accomplishment of General Plan goals.

11. New or expanded services should support the priorities reflected in the General Plan.
12. All competing requests for City resources should be weighed within the formal annual budget process.
13. Final actions on study items with significant financial impacts should be withheld until they can be made in the full context of all budgetary demands and constraints.

### **Long Term Financial Planning**

1. The City shall maintain a long term fiscal perspective by annually preparing a Twenty-Year Long Term Financial Plan for each fund. Those funds which account for intergovernmental grants will only include known entitlements.
2. Major financial decisions should be made in the context of the Twenty-Year Long Term Financial Plan.
3. Long term financial planning should enable the current service level provided to be sustained over time through the strategic use of reserves.
4. The Long Term Financial Plans should be used to communicate the fiscal impact of City decisions to all stakeholders whenever possible.

### **Performance-Based Budget System**

1. The operating budget will be prepared and managed on a program basis.
2. All costs attributable to a budgeted program will be fully reflected in program budgets (with the exception of capital costs of general-use public buildings and facilities).
3. An emphasis should be placed on achieving maximum work productivity to ensure an optimal allocation of human and fiscal resources for Council approved services and programs.
4. All operating programs must identify the service provided, the service level, and the resources necessary to accomplish the specific service level.
5. A performance measurement system will be maintained and used for trend analysis and evaluation of effectiveness and efficiency of budgeted objectives.

### **Budget Monitoring and Modification**

1. Expenditures for each department are legally limited to the amount authorized by the City Council in the Budget Resolution, plus subsequent changes individually approved by the City Council through Budget Modifications.

2. The City's annual budget may be modified at any Council meeting by a majority vote of the City Council.
3. The City's budget appropriation control shall be by program within the same fund for operating programs in the General Fund and Special Revenue Funds. For the Proprietary and Internal Service Funds, expenditures cannot exceed actual revenues plus the planned use of reserves.
4. Appropriations for capital and special projects shall be limited to the amounts contained on the Budget Resolution for each project. All modifications to project budgets require Council approval.
5. For programs with annual budgets over \$500,000, a Budget Modification approved by City Council is required for reappropriations among programs that exceed \$100,000 or 5% of the annual program budget up to a maximum of \$250,000. For programs with annual budgets less than \$500,000 the maximum reappropriation threshold is \$50,000. Lesser amounts may be authorized by the City Manager.
6. Any unexpended appropriations shall expire at fiscal year-end unless specifically reappropriated by the City Council for expenditure during the new fiscal year.

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## REVENUE POLICIES

In order to maintain or even enhance fiscal strength and stability over both short and long term planning horizons, effective revenue management policies must address such areas as tax equity/fairness, appropriate levels of cost recovery (user fees), accurate forecasting, and aggressive collections systems.

A basic, but no less important part of any revenue policy requires that a City's revenue base be diverse and stable to minimize the negative impact that revenue fluctuations have on City finances and on the taxpayers. It is equally important to target the use of one-time revenues to non-recurring expenditures.

The two major categories of revenues received by government are taxes and user fees. In 1978 Proposition 13 created a distinction between "general" and "special" taxes. A general tax is any tax imposed for general governmental purposes, while special taxes are collected or earmarked for a specific purpose or program. Restrictions on the establishment, extension, or increase of any tax were also imposed by Proposition 13 and Proposition 218 which was passed later in 1996. A majority vote of the electorate is required to change a general tax, and a two-thirds vote is required for a special tax. The taxes collected by the City are primarily general taxes which are used to support general governmental purposes. The major taxes received by the City are Property Tax, Sales Tax, Utility Users Tax, Transient Occupancy Tax, Franchise Tax, and Construction Tax.

User fees, in contrast, are charges imposed for services that benefit a specific segment of the community. Fees are distinguished from taxes in two principal ways. First the amount of the fee may not exceed the cost of providing the service, while the amount of a tax has no such restriction. Second, the service for which the fee is charged must bear a relationship to the person or entity paying the fee. In general, user fees are set to cover the full cost of providing the service, unless the Council chooses to charge a lesser fee to fulfill a specific public purpose. The City reviews its user fees annually to ensure cost recovery. User fees are published in the Annual Fee Schedule for reference by the public.

### **Revenue Base**

1. The City will maintain a diversified and stable revenue base, not overly dependent on any land use or external funding source.
2. Taxes levied by the City will be used for the purpose of financing services performed for the common benefit.
3. Taxes should be held at their lowest possible level, while maintaining Council-approved service levels.

4. When considering a new tax or revenue source or an increase in an existing tax or revenue source, the following criteria should be considered:
  - Community/voter acceptance
  - Competitiveness with surrounding communities
  - Efficiency of revenue collection and enforcement
  - Effectiveness in generating sufficient revenues in the short and long-term to justify its establishment
  - Enhancement of revenue diversity to promote stability and provide protection from downturns in business cycles
  - Equity/Fairness in distribution of the revenue burden on various segments of the community
5. Reliance on any restricted and/or inelastic sources of revenue will be avoided.
6. One-time revenues should not be used for ongoing expenditures.
7. Revenue should not be targeted for a specific program, unless a revenue source has been established for the sole purpose of financing a particular expenditure.
8. Potential new revenue sources will be investigated, particularly those that do not add to the tax burden of residents or local businesses.
9. Donations, contributions, and sponsorships may be accepted if they are in accordance with City policy and General Plan priorities.

### **Revenue Forecasting and Monitoring**

1. All revenue estimates must be conservative, objective and reasonable.
2. Revenue forecasts should be based on detailed information regarding historical performance and economic conditions whenever possible.
3. At least ten years data for all tax revenue sources will be maintained.
4. Revenues will be estimated for the budget year and for each planning year in the Twenty-Year Resource Allocation Plan.
5. Methods to maximize the accuracy of revenue forecasts will be established.
6. Estimated revenues from grant sources will be projected only to the specific date on which the entitlement will end.
7. Estimated intergovernmental revenues for which the City is eligible (but which are not guaranteed) will be forecast to assure that local matching funds will be available if the revenues are realized.

### **Revenue Collection**

1. The City will seek all possible Federal and State reimbursement for mandated projects and/or programs.
2. An aggressive collection system for all accounts receivable, including utility receivables, will be utilized to assure that monies due to the City are received in a timely fashion.



3. Monthly reviews and periodic audits of Transient Occupancy Tax returns will be conducted.
4. Monthly reviews and periodic audits of all major locally administered revenue sources will be conducted.
5. Periodic point-of-sale audits for Sales Tax will be conducted.

### **User Fees**

1. User fees should be used to recover the cost of services that benefit specific segments of the community.
2. User fees should be reviewed and adjusted at least annually to avoid major changes.
3. User fees and charges should not exceed the City's full cost of providing the service.
4. User fees should be established at a level which reflects the full cost of providing those services.
5. The City Council may determine for any service whether a subsidy from the General Fund is in the public interest.
6. User fees shall only be used when the cost of providing the service can be readily calculated and administered.
7. User fees should be adopted by Council resolution and included in the Annual Fee Schedule.

\*Note: For additional user fee policies specific to the Utility Funds or the Community Recreation Fund, please see those sections under Enterprise Fund policies.

## **CAPITAL IMPROVEMENT POLICIES**

Capital projects are major expenditures related to construction, improvement, or acquisition of capital assets. The assets can be in such forms as buildings, streets or street-related infrastructure, parks, and the various elements of the utility systems. The Capital Improvement Plan (CIP) projects the City's capital needs over a 20-year term. In the CIP development process the priority of projects is established and financing requirements are estimated to ensure that scheduled projects have available resources. A capital budget is adopted by Council each year to provide funds for projects scheduled for that year.

Capital improvement projects typically are costly, have a long life, and are highly visible to the community. For these reasons, it is important that the projects be designed to ensure that they are cost-effective while at the same time meeting the needs of the community. Once constructed, the asset should be maintained so that future repair and replacement costs are minimized. The City has a Long Range Infrastructure Plan in place that contains each city asset and projects when it will need to be repaired or replaced. This effort will prevent the City from major liabilities in the future resulting from deferred maintenance of its infrastructure assets.

### **Capital Improvement Plan**

1. An updated Twenty-Year Capital Improvement Plan shall be prepared on a two-year budget cycle.
2. The City shall fund only those Capital Improvement Projects that are consistent with the adopted Capital Improvement Plan, City priorities, and General Plan goals.
3. High priority should be given to replacing capital improvements prior to the time that they have deteriorated to the point where they are hazardous, incur high maintenance costs, negatively affect property values, or no longer serve their intended purposes.
4. New or expanded capital improvements should maximize value and avoid duplication whenever possible by partnering with other entities to pool resources or share facilities.
5. Priority will be given to the repair and replacement of existing infrastructure as compared to the provision of new or expanded facilities.
6. The decision on whether to repair or to replace an existing capital asset will be based on which alternative is most cost-effective or provides the best value to the City.
7. The operating impact of proposed capital projects, including ongoing operating expenditures, capital outlay, debt service, and infrastructure replacement will be identified in the Capital Budget and considered in the selection of projects for funding.

8. Staff will identify the estimated costs, potential funding sources, project schedule and relationship to the General Plan for each capital project proposal before it is submitted to the Council for approval.
9. Capital improvements should be maintained to the level required to adequately protect the City's capital investment and to minimize future maintenance and replacement costs.
10. A Capital Projects Fund shall be used to account for major capital acquisition or construction projects associated with the General Fund and other governmental funds. The capital projects of the Utility Enterprise Funds shall be accounted for within the respective fund.
11. The Infrastructure Renovation and Replacement Fund shall be used to account for projects related to the City's Long-Range Infrastructure Plan for the renovation and replacement of existing general City assets. Infrastructure projects related to the City's utilities shall be accounted for in the respective utility fund.

### **Funding**

1. Governmental capital improvements should be funded on a "pay-as-you-go" basis in most cases. Alternate financing strategies may be considered in light of the specific project and the consequences of each financing strategy.
2. Development-related improvements such as sidewalks, curbs and gutters, street lights, and water and sewer lines should be funded by those directly benefiting from the improvements.
3. The City will seek out and use intergovernmental funding sources for capital improvements, as is consistent with City priorities and General Plan goals.
4. Funds for the replacement of City assets originally paid for by a developer should be included in the Capital Improvement Plan of the appropriate City fund.

### **Design and Evaluation**

1. The planning and design of capital improvements should be based on standards that minimize construction costs, while assuring acceptable useful life and reducing maintenance requirements.
2. Budgeting for capital projects must reflect when the expenditures are scheduled to occur, using multi-year planning to ensure a reasonable time frame for projecting costs.
3. Improvements should be designed with the following goals: to maximize energy efficiency, require minimal maintenance, create an efficient physical relationship for those working in the facility, provide adequate capacity for the projected useful life, and to have the ability to accommodate future expansion with minimum remodeling costs.

## LAND POLICIES

Land is a major asset of the City, and the use, acquisition, and disposal of property by the City is a major policy decision which can have far-reaching effects on the City's financial condition. Based on historical value, the land owned by all funds is approximately \$120 million and buildings total an additional \$110 million. The City leases a number of its properties to outside entities for their use. Although the general policy is to lease property at market rates, certain properties are leased to third parties in order to fulfill Council policy objectives.

### **Acquisition, Disposition and Leasing of City-Owned Real Property**

1. A high priority will be given to acquiring undeveloped land needed to meet City goals before it is developed.
2. Developed land should be acquired in reasonable proximity to the time the property is required for City purposes.
3. Every effort shall be made to acquire property through negotiation, reserving the use of eminent domain for those circumstances when immediate possession is required and the property cannot be acquired through negotiation at a cost approximating market value.
4. The purchase, sale or lease of real property where the purchase or sale price or lease cost is more than \$75,000 shall be approved by the City Council.
5. The purchase, sale or lease of real property where the purchase or sales price or lease cost is less than \$75,000 shall be approved by the City Manager.
6. The lease of city property which results in revenue to the City and the term is less than or equal to 55 years shall be approved by the City Manager.
7. The lease of city property for a term longer than 55 years shall be authorized by the City Council by resolution following a public hearing.
8. Property leased to outside entities should be based on market rents except when the Council finds that there is a public purpose for leasing at a lower rate.
9. The net proceeds from the disposition of surplus City property owned by the General Fund shall be placed into the General Fund Reserve for Capital Improvements.
10. Proceeds from the sale of land or facilities originally purchased with monies from a specific fund should be kept within that fund.

## **RESERVE POLICIES**

Reserves maintained in various funds play a variety of roles in the City's fiscal strategies. Reserves may be established for any of the purposes listed below:

- To provide for contingencies or emergency situations
- To levelize the impact of the cyclical nature of the economy and maintain service levels over the long term
- To accumulate resources for specific purposes such as debt service, equipment replacement, or capital improvements
- To smooth cash flow or stabilize rates
- To provide funding for long-term liabilities
- To segregate funds that are legally restricted

The level of funding for each reserve is an important policy decision for City Council and should be appropriate to the City's particular circumstances.

### **General Fund Reserves**

1. The City shall maintain a General Fund Contingency Reserve of at least 20% of operating expenditures to cover emergencies or disasters.
2. The sale of surplus property owned by the General Fund and any other one-time revenues shall be placed into a Reserve for Capital Improvement Projects to be used for capital improvement or expansion.
3. The Twenty-Year Resource Allocation Plan (RAP) Reserve shall be used to levelize economic cycles and maintain stable service levels over the long term.
4. The Twenty-Year RAP Reserve should be balanced to zero in the twentieth year of the Long Term Financial Plan. This means that the reserve increases during periods of economic growth and has planned draw-downs during low periods of the economic cycle.
5. The Service Level Set-Aside will be used to provide ongoing funds to increase service levels or add new services. Once used, this Set-Aside may be replenished according to economic conditions.
6. Any other reserves may be established to segregate funds which are legally restricted to specific purposes.

### **Internal Service Fund Reserves**

1. The City will establish and maintain an Equipment Replacement Reserve to provide for timely replacement of the City's fleet, furniture and fixtures, technology and communication equipment.

2. Reserve levels for each type of equipment will be established based on the lifecycle of existing assets accounted for in the appropriate Sub-Fund of the General Services Fund.
3. Equipment replacement expenses should be amortized through the use of rental rate charges to be fully funded by users.
4. The Workers' Compensation Reserve shall be maintained at a level deemed adequate to meet projected liabilities as determined by an actuarial evaluation.
5. The Liability and Property Reserves will be maintained at a level which, together with purchased insurance policies, will adequately indemnify the City's property and liability risk. A qualified actuarial firm shall be retained in order to recommend appropriate funding levels.
6. An Actuarial Retiree Medical Reserve will be maintained at a level that is deemed adequate to meet projected liabilities as determined by an actuarial evaluation. This Reserve should meet the GASB reporting requirements for these future costs.
7. Rate Uncertainty Reserves will be funded for those employee benefits expenditures exhibiting high volatility or significant increases. The reserves will ensure adequate funding while minimizing the effect on the funding of other City operations.

## **DEBT MANAGEMENT POLICIES**

When debt is issued, the borrowing government becomes obligated to make regular debt-service payments for periods of 30 years or more. For this reason, debt service can impact a government's financial condition over the long term more than any other type of expenditure. It can also limit the government's flexibility to respond to changing service priorities or funding availability. As a result, policies are needed regarding the circumstances under which debt should be issued, limitations on the size of total debt and debt service, the types of debt that can be utilized, and the management of a debt portfolio.

In California, a variety of debt financing methods is used by municipal issuers to raise funds for capital projects. These include Certificates of Participation, Lease Financing, Revenue Bonds, Special Benefit Assessment Bonds, and General Obligation Bonds. Each of these has specific legal requirements regarding projects eligible for financing and sources of payment. Over the years, State law has limited the flexibility that cities have for issuing debt, particularly in the area of General Obligation Bonds. These Bonds, which are limited to the acquisition of and improvements to public land and property, involve the imposition of an additional ad valorem tax on property which must be approved by a 2/3 vote of the electorate.

The City Charter limits the total general bonded indebtedness to 15% of the total assessed valuation of property within the City. In practice, the City has issued debt on a very limited basis over the years and the total debt burden is very small. This conservative approach has resulted in the City maintaining a very strong overall credit rating with the national credit rating agencies. This rating, in turn, insures that borrowing can be done at very favorable rates.

### **Debt Limits and Debt Capacity**

1. Total bonded indebtedness supported by General Fund revenues should not exceed 5% of assessed valuation of property within the City. Bond issues supported by the General Fund should be restricted to annual debt service of 5% of General Fund revenue.
2. Land based financings should maintain a minimum property value-to-debt ratio of 3:1, with exceptions made for special circumstances at Council's discretion.
3. Debt service should not affect the City's ability to meet future operating, capital and reserve requirements.

## **Debt Issuance**

1. Debt should be used only to finance improvements that cannot be paid for with current revenues, unless the purpose of the debt is to spread improvement costs over a longer period of time and ensure that future users become responsible for portions of the cost.
2. There should be no short-term (debt) borrowing to support routine operations unless (a) the borrowing will be at a lower interest rate than the rate on invested funds, and (b) funds are available for routine operations.
3. An internal feasibility analysis will be prepared for each long-term financing which analyzes the impact on current and future budgets.
4. Bond issues should be scheduled to equalize annual debt service requirements to the degree that borrowing costs can also be minimized.
5. Generally, the method of financing selected for debt issuance should be based on who will benefit and who should pay for the cost of improvements. The following are guidelines:
  - General Obligation Bonds – For major improvements that are of community-wide benefit and use, such as general municipal facilities and parks. These are funded by ad valorem taxes and require 2/3 voter approval.
  - Assessments - For new subdivision improvements and for City improvements where the Council has determined that a specific benefiting group should be responsible for payment.
  - Tax Increment Bonds - For improvements in the Redevelopment Project Area where rehabilitation or redevelopment is required. These bonds are financed by tax increment from the project to be developed.
  - Certificates of Participation - Where backing by the full faith and credit of the City is the most cost-effective method. If this method is proposed, a full cost analysis will be done.
  - Revenue Bonds – All City utility-related improvements shall be funded only from revenues of the respective utilities.
6. The maximum term of each bond issue should be no longer than the expected useful life of the asset financed.
7. Refunding of outstanding bond issues shall be considered if the net present value savings is at least 3%, or if it is necessary to remove a burdensome or restrictive bond covenant.
8. The City will consider requests for conduit financing on a case-by-case basis, taking into consideration the borrower's credit worthiness, the purpose of the borrowing and its relationship to City priorities, and any impact on the City's financial position.
9. Debt financings will generally be conducted on a competitive basis. However, negotiated financings may be used due to market volatility or the existence of an unusual or complex financing or security structure.
10. Fixed or variable rate financing may be used, depending on the cost benefit to the City of each option.



### **Debt Management**

1. The City will diligently monitor its compliance with bond covenants and ensure adherence to federal arbitrage and disclosure regulations.
2. Debt financing should not exceed the anticipated useful life of an improvement.
3. The City will seek to maintain and, if possible, improve its current bond rating(s) in order to minimize borrowing costs and preserve access to credit.
4. A Debt Service Reserve shall be maintained for each debt issue as required by the respective bond covenants.

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## **ACCOUNTING POLICIES**

The City's accounting system and financial management practices conform to generally accepted accounting principles established by the Governmental Accounting Standards Board (GASB) and its predecessor, the National Committee on Governmental Accounting. The City Charter requires that the City undergo an independent financial audit each year.

The City has a duty of stewardship for the resources entrusted to its care. The citizens expect managers of public resources to take every reasonable precaution to prevent the misuse or diversion of public funds. To that end, the City maintains a system of checks and balances designed to ensure that all financial transactions are in compliance with financial policies. A system of internal controls is also in place to prevent loss due to fraud, employee error, or imprudent action. Financial reviews are conducted each year on various transactions as identified by the City Manager.

Internal controls are also important to assure that management is accomplishing its objectives and meeting its responsibilities. Operational audits are conducted as needed in order to verify that the business of the City is being conducted in the most efficient and effective manner and to identify areas for improvement. Additionally, performance audits are conducted on every City program over an eight-year period to verify that the results reported by program managers are complete and accurate.

### **Accounting Principles**

1. A Comprehensive Annual Financial Report (CAFR) will be prepared each year within six months of the close of the previous fiscal year.
2. The CAFR shall be prepared in accordance with generally accepted accounting principles applicable to local governments, and shall receive an unqualified opinion by the City's independent auditor each year.
3. The Government Finance Officers Association (GFOA) Certificate of Achievement for Excellence in Financial Reporting should be pursued annually.
4. The accounting system shall provide a mechanism to fund accrued benefits liabilities.
5. Pension obligations will be fully funded annually and current pension contributions will not be deferred to balance current expenditures.
6. An integrated accounting and budgeting system will be maintained so that production and cost for each activity can be calculated and evaluated.
7. The City Council shall be provided with periodic summary financial reports, by fund, comparing actual revenues and expenditures to budgeted amounts.
8. The City shall maintain a full cost accounting system.

9. A city-wide Cost Allocation Plan shall be developed to identify the cost of administrative support for all City departments and special funds.
10. The “modified approach” to account for streets infrastructure capital assets, as defined by GASB No. 34, shall be utilized for the City’s street network. The City Council will establish a range of acceptable condition levels for the street network on a biennial basis and the City Manager will set the actual target condition level(s) each year.
11. The City shall establish such separate funds as required by law to account for grant funding and other revenues limited to specific use.
12. Internal Service Funds shall be used to account for the financing of goods and services provided by one department or agency to other departments or agencies of the City.
13. Internal Service Funds shall be used to equitably distribute facility, vehicle and equipment replacement and maintenance costs among City user departments and to assure that adequate funding is on hand to replace/maintain assets and pay liabilities.
14. Internal Service Funds shall be maintained to account for employee benefits and to provide a mechanism to fully fund accrued benefit liabilities.

### **Internal Controls**

1. A system of effective internal controls shall be maintained that assures only properly authorized expenditures, recordings of financial transactions, and accounting entries are executed and provides for the physical security of City funds and assets.
2. Periodic financial reviews will be conducted to assure that adequate internal controls exist, at a reasonable cost, and that fiscal practices are in compliance with Federal, State and City rules and regulations.
3. Operational audits will be conducted to evaluate the efficiency and effectiveness of City functions.
4. Performance audits will be conducted regularly on a schedule set by Council to verify that the performance data reported by each Department is complete, valid and accurate.

## **PURCHASING POLICIES**

The City obtains the goods and services required to support its operations through a centralized purchasing system as required by the City Charter and Municipal Code. The intent of this system is to ensure that purchases are consistently made on a fair and objective basis, in the best interest of the City and at the lowest cost to Sunnyvale citizens.

### **Centralized Purchasing System**

1. Whenever possible, purchases will be made through a competitive bid or proposal process.
2. Purchasing policies and procedures will be as fair and open as possible so that everyone involved will understand the elements of the process, including procedures, timelines, expectations, requirements, and criteria for supplier selection.
3. A preference of 1% shall be given to local businesses in the evaluation of bids and proposals in the procurement of goods. Contracts exempt from this preference are:
  - Emergency procurement
  - Sole source contracts
  - Contracts funded from grants, donations, or gifts with special conditions that specify otherwise
4. Purchases of goods and services will be made from locally owned businesses whenever possible, in accordance with purchasing regulations.
5. The City will actively seek opportunities to participate with other public agencies in the development of competitive bids that combine purchasing power to achieve volume pricing.
6. City staff shall not use their position for personal gain in any procurement.
7. Environmentally responsible procurement policies will be used where possible, to encourage recycling, reduce waste, conserve energy and natural resources and protect environmental quality.
8. Technological advances that present more efficient and effective ways to purchase goods and services will be encouraged.
9. An efficient and effective system of inventory management for City-stocked items and for sale or disposal or surplus items will be maintained.

## ENTERPRISE FUND POLICIES

### Utility Fund Policies

The City operates three Enterprise Funds that provide utility services to the citizens of Sunnyvale: Water Supply and Distribution; Wastewater Management; and Solid Waste Management. In addition, the City operates the Sunnyvale Materials Recovery and Transfer (SMaRT®) Station in partnership with the cities of Mountain View and Palo Alto as an Enterprise Fund. Each municipal utility is accounted for in a separate fund. Each fund is self-sufficient with resources generated by the utility used to fully fund operations, maintenance, administration, debt service, capital projects and reserves.

Although most of the City's financial policies apply to all funds, the nature of the utility enterprises requires some policies which are specific to these types of operations. Of particular importance are the reserves established in each utility fund. Because the utilities are supported entirely by fees for service, it is important to identify the particular risks and unique needs of each operation and establish reserves to provide financial viability. The Water and Wastewater Funds, for example, have extensive operations and expensive capital assets, whereas the Refuse Collection Fund employs a contractor to provide service and thus has less risk of equipment failure. Therefore the reserves established are different.

Especially important to the Water and Wastewater Funds is the issue of system repair and replacement. A method should be established to provide resources for the ongoing repair, replacement, and rehabilitation as part of the user rates. A utility's duty to serve outlasts the life of its existing infrastructure, and utility services provided today are using up capital resources which must be replaced to serve future customers. At a minimum, utilities should target to fund depreciation each year. This means that rates are set at a level at which revenues not only cover all obligations of the utility, but also the annual depreciation expense. This depreciation expense should be set aside as cash in a reserve to be drawn upon for capital needs. The reserve is not intended to entirely cash fund all future repairs and replacements, but instead serves as a sinking fund which helps to keep rates from spiking during periods of high capital needs. Other sources such as current rates and bonded indebtedness also will be needed to provide funds for the total capital requirements.

### Accounting and Fund Management

1. The financial activities of each utility should be accounted for in a separate fund.

2. The City will assure that all direct and indirect costs of each utility are fully cost-accounted.
3. Expenses which are incurred to support more than one utility should be allocated to each utility in a manner that reasonably reflects the benefit received.
4. Each utility fund shall reimburse the General Fund, and/or other applicable funds, for the full cost of general government support services provided to that utility.
5. The user fees established for each utility will be reviewed annually and set at a level that will support the total costs of the utility, including direct and indirect costs and contributions to reserves set by Council policy.
6. In the event that any utility requires one-time resources from other City funds to support its operations, or that the utility provides resources to an unrelated program, the use of these funds should be accounted for as an inter-fund loan.
7. Debt service coverage should be maintained for each bond issue as required by the bond covenants.
8. No utility resources shall be used to fund unrelated General Fund services.

#### Capital Program

1. Capital improvements associated with the existing infrastructure of a utility should be primarily funded from two sources: rate revenue and debt financing.
2. New improvements or expanded capacity in any utility should be funded by those benefiting through specific charges, such as connection fees, impact fees, or mitigation fees.
3. Local, state, and federal funding sources, such as grants and contributions, should be pursued for utility-related capital improvement projects consistent with City priorities.
4. Water and wastewater improvements should be designed and constructed to the size required to serve the City's capacity needs when fully developed plus any required redundancy to assure reliable operation and provision of service.
5. Bonded debt financing should be used for capital improvements as appropriate to:
  - Make cost recovery of an asset more consistent with its useful life
  - Equitably assign cost over multiple generations of customers who use the assets
  - Smooth near-term rate impacts of the project
6. Total bonded debt should equal no more than 30% of the utility's fixed assets.
7. Resources for the capital requirements of each utility such as bond proceeds or connection fees should be dedicated only for capital projects and not be used for ongoing maintenance and operations.

8. The annual depreciation expense of the assets of each utility should be set aside into a Rehabilitation and Replacement Reserve as a minimum funding level for system replacement.

### Reserves

1. A Contingency Reserve of 25% of operating expenses shall be maintained in the Water and Wastewater Funds to allow approximately 90 days of working capital in case of emergency.
2. A Contingency Reserve of 10% of operating expenses shall be maintained in the Solid Waste Fund. This lower reserve is appropriate because the asset value of the Solid Waste Fund is substantially smaller than the other city utilities, and because operations are performed by contract, with insurance and bonding requirements as part of the contract assuring the continued operation in the case of an emergency.
3. In the event that the Contingency Reserve of any utility fund is used it shall be replenished by the end of the following fiscal year or as soon as practical thereafter considering the circumstances that prompted the need to use the reserve.
4. A Capital Replacement Reserve shall be maintained in the SMaRT Station Replacement Fund to account for contributions from the three participating cities for the replacement of City-owned SMaRT Station equipment.
5. A Rate Stabilization Fund shall be maintained in each utility fund to levelize the rates and annual rate increases in light of fluctuations in financial requirements from year-to-year.
6. A Capital Rehabilitation and Replacement Reserve for each utility should be established to provide resources for the infrastructure replacement needs of the respective utility system. This reserve should act as a sinking fund for annual depreciation expense of the utility assets.
7. Debt service reserves should be maintained for each bond issue as required by the bond covenants.

### Community Recreation Fund Policies

The Community Recreation Fund accounts for the recreation activities of the City. Included in this Fund is responsibility for two City-operated golf courses and the tennis center. The Fund and its operating budget are based on providing wide-ranging and balanced recreation programs and services for the entire community. Activities are funded by user fees and a subsidy from the General Fund.

Prior to the creation of the Community Recreation Fund in FY 1991/1992, recreation services were part of the General Fund. The creation of the Community Recreation Fund included the merger of the City's golf and tennis operations with the remainder of all other recreation services, as well

as the adoption of new, entrepreneurial approaches to service delivery. This approach resulted in a significant reduction in the General Fund subsidy that would have been required to support recreation services in future years. In FY 2006/2007, several changes were made to fully define the services and activities that are provided through the Community Recreation Fund versus those that are provided in the General Fund. The subsidy, which will be used as a base in future years, was adjusted to reflect these changes.

#### Fund Management

1. The General Fund subsidy received by the Community Recreation Fund shall be fixed at the FY 2006/2007 level as the base year and increased annually by the inflation factor included in the recommended budget for the upcoming year.
2. Any increase in service levels by City Council not covered by an increase in revenues will result in a corresponding increase to the General Fund subsidy.
3. Any action by City Council to decrease revenues of the Community Recreation Fund not covered by a decrease in operating costs will result in a corresponding increase to the General Fund subsidy.
4. The infrastructure rehabilitation and replacement of all facilities on park land, including the golf courses and tennis center, will be funded first through the Park Dedication Fund if funds are available.
5. A Fee Waiver system should be provided to allow persons who are economically disadvantaged to participate in and utilize programs, facilities, and services provided by the Community Recreation Fund. The criteria for eligibility in this system shall be established by Council policy.

#### User Fees

1. Golf fees shall be set annually utilizing market-based comparisons and included in the City's Annual Fee Schedule adopted by Council resolution.
2. User fees for recreation services shall be set administratively by the Director of Parks and Recreation in accordance with a documented methodology that depicts a relationship to cost recovery, market forces, and adjustments based on such factors as:
  - Perceived benefit to the community
  - Pricing which favors Sunnyvale residents over non-residents
  - Target populations
  - Promotional and marketing considerations
3. The fees established administratively by the Director of Parks and Recreation shall be published at least twice a year.



### Reserves

1. The Community Recreation Fund shall maintain a Twenty-Year Resource Allocation Plan Reserve to stabilize economic cycles and maintain service levels over the long term.
2. Any fund balance remaining in the Community Recreation Fund shall remain in the Fund for use in subsequent years.
3. The Community Recreation Fund will maintain a Co-op Sports Reserve to administer the after school intra-mural sports league programs at Sunnyvale Middle School and Columbia Middle School as required by agreement with the Sunnyvale School District.

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